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No. 131

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

MARGARET L. HOLT and KATHLEEN L. McMAHON, individually and on behalf of all other shareholders of Alleghany Corporation similarly situated,
Petitioners,

v.

ALLEGHANY CORPORATION, ALLAN P. KIRBY, CHARLES T. IRELAND, JR., and FRED M. KIRBY

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR PETITIONERS

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INDEX

	PAGE
Opinions Below	1
Jurisdiction	2
Question Presented	2
Federal Rule Involved	3
Statement	3
The Nature of the Litigation in Which Intervention is Sought	3
Kirby Reacquires Control	4
The Split Decision by the Original Panel in the Court of Appeals Leads to a 4 to 4 Deadlock on Rehearing En Banc	4
The Board Abandons the Litigation and Petitioners Move to Intervene	5
The Opinions of the Court of Appeals	7
Summary of Argument	9
Argument	
I. Representation by the Kirby Board is Inadequate Under the Meaning of Rule 24(a)(2)	10
1. The Leading Cases	13
2. The Defendants' Authority	17
3. Failure to Prosecute a Meritorious Claim Could, if Necessary, Permit Intervention	19
II. The Motion to Intervene Was Timely Under the Meaning of Rule 24(a)(2)	23
Appendix	25

Table of Authorities

PAGE

CASES:

Atlantic Refining Co. v. *Standard Oil Co.*, 304 F.2d 387 (D. C. Cir. 1962) 13, 14

Cameron v. *President and Fellows of Harvard College*, 157 F.2d 993 (1st Cir. 1946) 24

Sam Fox Publishing Co. v. *United States*, 366 U.S. 683 (1961) 17, 19, 20, 21

Kozak v. *Wells*, 278 F.2d 104 (8th Cir. 1960) 15, 24

Molybdenum Corporation of America v. *International Mining Corp.*, 32 F.R.D. 415 (S.D.N.Y. 1963) 16, 21

Park & Tilford v. *Schulte*, 160 F.2d 984, cert. den. 332 U.S. 761 (2d Cir. 1947) 13, 15, 16

Pellegrino v. *Nesbit*, 203 F.2d 463 (9th Cir. 1953) 13, 14, 15, 16, 20, 24

Swanson v. *Traer*, 249 F.2d 854 (7th Cir. 1957) 21, 22

Tennessee Coal, Iron & R. Co. v. *Muscoda Local 132*, 5 F. R. D. 174 (N. D. Ala. 1946) 24

Wolpe v. *Poretsky*, 144 F.2d 505 (D. C. Cir. 1944), cert. den. 323 U.S. 777 ..... 13, 14, 20

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BRIEF FOR PETITIONERS

Opinions Below

The opinions of the Court of Appeals, Judge Hays dissenting, are reported at 344 F. 2d 571. The District Court did not render an opinion. Its order, dated April 9, 1965, together with the oral remarks of the Honorable Sylvester J. Ryan, D. J., in lieu of an opinion, are printed at R. 82.

Jurisdiction

The Court of Appeals rendered its decision April 21, 1965, and judgment was entered that day (R. 2380). It denied petitioners the right to intervene in *Alleghany* v. *Kirby** for purposes of presenting a petition for a writ of certiorari. Since this petition as to the right to intervene (No. 131) and the petition as to the merits of Alleghany v. Kirby (No. 132) are "mutually dependent", Mr. Justice Harlan by order and memorandum dated April 27, 1965 (R. 2390-2391), made the filing of both petitions by May 12, 1965, a condition to his grant of an extension to that date of the time within which to file the petition on the merits of *Alleghany* v. *Kirby*. Both petitions were filed May 12, 1965 and granted June 1, 1965. At that time the appeals were consolidated for argument (R. 2391-2).

Jurisdiction of this Court on this petition is invoked under 28 U. S. C. 1254 (1) and Federal Rule of Civil Procedure 24(a)(2).

Question Presented

Where the principal defendant reacquired control of a corporation during the pendency of an appeal of its case against him, do minority shareholders have the right to intervene under Federal Rule 24(a)(2) to petition for a writ of certiorari upon learning that the new Board of Directors has voted to abandon the case by instructing the corporation's attorneys not to petition for such a writ?

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*Reported on rehearing en banc at 340 F. 2d 311, affirming by an evenly divided court (4-4) the judgment of the District Court whose opinion is reported at 218 F. Supp. 164. The three opinions of the original Second Circuit panel are reported at 333 F. 2d 327 (2-1 for affirmance).

Federal Rule Involved

Federal Rule of Civil Procedure Rule 24(a)(2) is set forth in full in the appendix to this brief. In pertinent part it provides:

> "(a) Intervention of Right. Upon timely application anyone shall be permitted to intervene in an action: * * * (2) when the representation of the applicant's interest by existing parties is or may be inadequate and the applicant is or may be bound by a judgment in the action; * * *."

Statement

The Nature of the Litigation In Which Intervention is Sought

This action was commenced in the Southern District of New York on September 8, 1960, as a derivative action on behalf of Alleghany Corporation ("Alleghany") against its then controlling shareholder and chief executive officer and certain other of its directors (R. 10-11). It involves a controversy as to the validity of Kirby's settlement of prior parallel and related derivative actions pending against him and others in the United States District Court for the Southern District of New York and the New York Supreme Court in and for New York County. It is alleged that the settlement was fraudulent and should be set aside or nullified and relief granted on the underlying claim. In the alternative, damages are sought in a sum in excess of $62,000,000, the value of the securities unlawfully obtained from Alleghany's portfolio in a self-dealing transaction which was the subject of the prior actions and fraudulent settlement (R. 12). Following a change in management, Alleghany itself assumed prosecution of the action pursuant

to an order of the District Court made and entered June 26, 1962 (R. 12). Thereafter, the case was tried and appealed as one brought by the corporation.

On June 5, 1963, the District Court entered judgment dismissing the complaint (reported *sub nom. Alleghany* v. *Kirby*, 218 F. Supp. 164) and Alleghany noticed an appeal, which was argued orally before the Second Circuit on December 2, 1963 (R. 13).

Kirby Reacquires Control

Two days after that oral argument, control of Alleghany passed back to defendant Kirby (R. 13) at a special meeting of the stockholders, which was called to give effect to Kirby's purchase of sufficient shares to give him direct control of the corporation (R. 13). Kirby exercised his stock control by electing a new Board, which included himself, his two sons and defendant Ireland (R. 13).

The Split Decision by the Original Panel in the Court of Appeals Leads to a 4 to 4 Deadlock on Rehearing En Banc

On May 19, 1964, the Second Circuit affirmed the dismissal of the complaint by a divided court, with three opinions (333 F. 2d 327). Judge Friendly wrote a vigorous dissent, which he concluded with the observations that he would reverse, order a further hearing, and

> "Since Kirby has regained control of Alleghany, I would instruct the judge to make provision for the continued prosecution of the action free from any control by the present directors." (333 F. 2d at 348)."

Because of Judge Friendly's observation, an application was made to the Second Circuit by Townley, Updike, Carter

& Rodgers (counsel from the inception prosecuting this case; hereafter "Townley Updike") for an order authorizing the taking of such further steps as were necessary, including the filing of a petition for rehearing, to protect the interests of Alleghany and its minority shareholders, or, in the alternative, for an order making such other provision for the continued prosecution of the appeal, free from control by the Kirby Board, as that Court deemed just.*

Judge Friendly's warning, and the application it prompted, did not go unnoticed. Before the court acted on the latter application, the Alleghany Board, including defendant Kirby as well as defendants Charles T. Ireland, Jr. and Fred M. Kirby, voted unanimously to authorize a petition for rehearing *en banc*. The petition was prepared and filed (R. 13-17).

Rehearing *en banc* was granted 4 to 3 on July 22, 1964, Judges Waterman, Friendly, Smith and Hays voting in favor of the petition, Judges Moore, Kaufman and Marshall voting against. (Judge Lumbard abstained, and one place on the bench was vacant due to Judge Clark's death) (R. 2372). Accordingly, the case was briefed to the whole Court. After Judge Anderson filled the vacant place on the Court, and on January 12, 1965, the *en banc* Court rendered a per curiam decision which noted that the Court was evenly divided as to the proper disposition of the case with four judges (Moore, Kaufman, Marshall and Anderson) voting for affirmance and four judges (Waterman, Friendly, Smith and Hays) voting for reversal (340 F. 2d 311). Judgment was entered accordingly.

The Board Abandons the Litigation and Petitioners Move to Intervene

On February 9, 1965, the Alleghany Board met and considered the written opinion of Townley Updike, counsel

*Affidavit of Stuart N. Updike dated June 1, 1964 (original record p. 1628).

of record, which recommended that a petition for certiorari be filed. That Board also had obtained an opinion of outside counsel advising that the directors would not be personally liable whether they authorized such a petition or not (R. 14, 29, 7-9b). This time, unlike the situation when the Kirby Board considered rehearing, defendant Kirby, as well as Allan P. Kirby, Jr., and defendants Ireland and Fred M. Kirby, all absented themselves from the meeting prior to the Board's consideration and vote on proceeding with or abandoning the case (R. 14). The remaining members of the Board voted unanimously (one member abstaining) not to authorize a petition for certiorari. Alleghany requested, received and paid the final bill of Townley Updike (R. 14).

The Board's decision was not communicated to its shareholders by letter or by any other public announcement (R. 37). It was not until April 4, 1965, that the petitioners, who own between them Alleghany preferred stock with an aggregate market value of approximately $60,000 (R. 15, 17), learned of that decision. They then determined to move, retaining Townley Updike as their attorneys, for permission to intervene in order to petition this Court in the right of Alleghany for a review that would resolve the issues which had deadlocked the Second Circuit (R. 11).

On April 8, 1965, petitioners obtained an order requiring the Corporation and defendants to show cause before the United States District Court for the Southern District of New York why intervention should not be permitted as of right so that they, as shareholders of Alleghany, might petition for a writ of certiorari (R. 38). The following day, Friday, April 9, 1965, Chief Judge Ryan heard the motion because the trial judge had died. Counsel representing the defendants, as well as new counsel representing Alleghany, strongly opposed the motion. Alleghany's decision to oppose

was made, we were informed, by a telephone poll of the Kirby Board (R. 52). Judge Ryan denied the motion for intervention from the bench, on the grounds that it was not timely and that the interests of the intervenors had been adequately represented (R. 82).

On Monday, April 12, 1965, the last day to petition for certiorari, petitioners applied to the Second Circuit *en banc* for an order recalling its mandate and allowing intervention, or in the alternative, treating the papers on that application as an appeal from Judge Ryan's denial of intervention the preceding Friday (R. 38, 39). Petitioners also applied to Mr. Justice Harlan for an extension of time to file a petition on the merits so that the right to do so would not be lost.

On April 12, the Second Circuit *en banc* denied the motion to recall the mandate and ordered a prompt appeal, with briefs due April 15 and oral argument on April 19 (R. 2378). Mr. Justice Harlan was informed of this disposition, and on April 13 granted an extension of time to file a petition on the merits within five days after the Second Circuit's decision on the intervention appeal or until April 29, whichever date was earlier (R. 2389).

The Opinions of the Court of Appeals

The intervention appeal was argued to a three-judge panel of the Second Circuit on April 19, and on April 21, by a divided court, it affirmed the denial of intervention. Judge Kaufman, with Judge Anderson concurring, wrote for the majority. Judge Hays dissented in a separate opinion (R. 2387).

Although the case was being abandoned by a Board chosen by Kirby, so that there was to be no representation of the shareholders' interests in the courts, the majority ruled that petitioners had failed to show that their interests as minority shareholders were inadequately represented

within the meaning of Rule 24(a)(2). It held that in the absence of a showing of bad faith, collusion or negligence, the petitioners were not entitled to intervene. It reasoned that Kirby and other defendants absented themselves leaving "independent" directors to determine whether Alleghany should proceed. Judge Hays, in dissent, succinctly pointed out the frailty of this reasoning in the face of Kirby's direct control of the Corporation, stating that it was "naive to believe that the Board of Directors was not subject to the determinative influence of Kirby when it voted not to proceed with this case" (R. 2387).

The majority also ruled that petitioners were not timely, even though they applied for intervention only four days after learning of the corporate decision to abandon the case, a decision that had not been communicated to the shareholders by notice or by public announcement. Judge Hays, on the other hand, held that the application was timely since the intervention would obviously not prejudice or delay the conduct of the action by the original parties, which in his view was the only relevant consideration.

On April 26, petitioners renewed their motion for enlargement of time to file a petition on the merits so that this Court would have an opportunity to consider a petition as to the right to intervene. Mr. Justice Harlan, in a memorandum, enlarged the time for a petition on the merits to May 12, 1965, upon the condition that this petition also be filed on or before that date (R. 2390-2391).

On June 1, 1965 both petitions were granted and consolidated for argument (R. 2391-2392).

SUMMARY OF ARGUMENT

I.

The issue of inadequacy must be determined by reference to the following facts: The prime defendant, Allan P. Kirby, controls the plaintiff corporation and has chosen its Board. That Board voted to abandon this litigation after the 4-4 split by the Second Circuit raised substantial questions and manifested that this case has merit. Taken together, these facts establish that representation here was inadequate.

Under such circumstances, no showing of bad faith, collusion or negligence on the part of the Board is necessary on a motion to intervene under Rule 24(a)(2). The contrary holding of the majority below is in conflict with decisions in the Courts of Appeals for the Ninth and District of Columbia Circuits. It also appears to alter the rules on intervention in the Second Circuit.

If not reversed, the decision will allow one in control of a corporation which has a suit against him to end that suit by his power to name the Board. Minority shareholders will then be helpless to prevent destruction of the corporate claim by empty ceremonials of a board whose members owe their position to the one in control.

II.

The requirement of Rule 24(a)(2) that the motion to intervene be timely refers to making the application at a time when it will not delay or prejudice the conduct of the original action by the parties. The motion here did not do so; hence, it was timely.

Even if timeliness is not determined by the absence of prejudice or delay and turns on when representation became

inadequate, the intervention motion here was timely. Representation became inadequate when the Kirby Board abandoned the litigation. The motion was made within four days after petitioners learned of the Board's action.

I. REPRESENTATION BY THE KIRBY BOARD IS INADEQUATE UNDER THE MEANING OF RULE 24(a)(2)

Under Rule 24(a)(2) a timely application for intervention must be granted as a matter of right if existing representation is inadequate. Three factors show inadequacy of representation here:

1. Allan P. Kirby, the principal defendant in the action in which petitioners seek to intervene, acquired direct control of Alleghany during the pendency of Alleghany's appeal in the Court below and personally selected a new board. Hence, that board is not genuinely disinterested.

2. Kirby's Board, by refusing to authorize application for a writ of certiorari to this Court, abandoned this litigation entirely, thus forsaking an opportunity to recover for Alleghany approximately $60,000,000 from Kirby in the event that this Court on the merits reverses the Second Circuit.

3. The 4-4 split by the Second Circuit raises substantial and important questions as to the correctness of the disposition of this case. That split, and the record that gave rise to it, establishes that the claim asserted merits further review.

The majority opinion below, in concluding that petitioners have been adequately represented, ignored the first of these factors, *i.e.*, Kirby's control of Alleghany and the

consequential lack of genuine disinterest by the Board. The majority apparently assumed that petitioners' application for intervention rested solely on the proposition that failure to prosecute, coupled with the 4-4 split, alone made out inadequate representation. While petitioners believe that there is both reason and authority for such a rule (see discussion below at pp. 19-21), it is neither the rule urged here nor the position taken in the Court of Appeals. Petitioners have insisted throughout, as they do here, that a key factor in their motion to intervene is Kirby's control of Alleghany.

On that issue there is no dispute: Mr. Granville Whittlesey, Jr., counsel for Kirby in this case, stated in an affidavit to the Second Circuit that (R. 13):

> "* * * At the meeting on December 4th, control of Plaintiff-Appellant Alleghany Corporation will pass from the present management *directly into the hands of Defendant-Appellee Allan P. Kirby.*" (Emphasis added.)

Judge Friendly, in his dissent in *Alleghany v. Kirby,* recognized the significance of Kirby's resumption of control (R. 2369):

> "Since Kirby has regained control of Alleghany, I would instruct the Judge to make provision for the *continued* prosecution of the action free from any control by the *present directors.*" (Emphasis added.)

Judge Friendly was correct in perceiving that the present Board would not be genuinely disinterested. That Board, selected by Kirby, is composed of 13 directors, 4 of whom, we are told, had left the room when the rest voted to discontinue this litigation (*i.e.,* Allan P. Kirby, Fred M. Kirby and Charles T. Ireland, Jr., all defendants, plus

Allan P. Kirby, Jr.) (R. 20). The degree of disinterest of the other nine* may be judged by the following:

(1) Andrew Van Pelt was a member of Alleghany's Board which authorized the Kirby-Young-Purcell self-dealing transaction which the original panel of the Second Circuit found "illegal" (R. 1039). Hence, he was named a co-defendant of Kirby in the prior derivative litigation (R. 701) which this action seeks to re-open.

(2) and (3) William G. Rabe and Charles T. Hill were directors who voted to approve Kirby's 1959 settlement of the prior derivative actions (R. 999, R. 1000-1009), the settlement directly under attack here. In addition, Mr. Rabe and Mr. Hill were named defendant-directors in this action. Both were dropped as named parties when the Corporation took over the action in 1962 (R. 2).

(4) Murray D. Lincoln represents the shares owned by the Nationwide Insurance Group (R. 48, n. 3). That Group has a reciprocal voting agreement with Kirby dated December 14, 1962, whereby it promises to vote for Kirby's nominees to the Alleghany Board in return for Kirby's promise to vote for nominees of Nationwide (R. 48, n. 3). Together, Kirby with his 4,084,813 shares and Lincoln, representing 789,400 shares, controlled nearly 50% of Alleghany's voting stock (R. 48) at the time in question. This alliance, therefore, gave them virtually absolute power over Alleghany and its Board.

(5) Daniel E. Taylor was a nominee of the losing Kirby slate in the Alleghany proxy contest which tem-

*One unidentified member of the nine abstained from voting on the question of continued prosecution of this action (R. 20).

porarily wrested control from Kirby (R. 47). He returned to the Alleghany Board when Mr. Kirby resumed control in December, 1963 (N. Y. Times, Nov. 7, 1963; Dec. 5, 1963, pp. 69-70).

(6)-(9) Robert S. Odell, James S. Hunt, James W. Deer and Walter S. Davies all represent corporate interests that participated in the stock transactions which returned Mr. Kirby to "direct control" (R. 13) of Alleghany in December, 1963 (N. Y. Times, Dec. 5, 1963, pp. 69-70).

It is Kirby's control and the composition of the Board, taken together with the abandonment of the litigation in the face of the substantial questions raised by the 4-4 split that requires the granting of intervention here. When these factors are considered, the holding of the majority that the petitioners here must make a positive showing of bad faith in order to intervene clearly conflicts with decisions in both the Ninth Circuit, *Pellegrino* v. *Nesbit,* 203 F. 2d 463 (1953), and the District of Columbia Circuit, *Atlantic Refining Co.* v. *Standard Oil Co.*, 304 F. 2d 387 (1962); *Wolpe* v. *Poretsky,* 144 F. 2d 505 (1944). The majority opinion also appears to alter the previous rules governing intervention in the Second Circuit. *Park & Tilford* v. *Schulte,* 160 F. 2d 984, cert. den. 332 U. S. 761 (1947).

1. The Leading Cases.

The foregoing cases stand for the proposition that in circumstances such as are present here, intervention does not require a showing of bad faith, collusion or negligence.

a. *Pellegrino* involved a shareholder's attempt to intervene in an action by a corporation against certain key em-

ployees for insider profits. The court held that where the corporation's board of directors had decided not to appeal an adverse judgment, representation of the minority interest was inadequate, and he was entitled to intervene under Rule 24(a)(2) (the precise rule and subparagraphs involved here). There was no requirement and no finding of bad faith, collusion or negligence.

b. In *Atlantic Refining Co.*, intervention was sought in a declaratory judgment action against the Secretary of the Interior to present defenses other than those already asserted. The Circuit Court, holding that the representation in the action was indaequate under Rule 24(a)(2), declared (304 F. 2d at 392):

> "In order to establish that representation of interest of the applicant for intervention by existing parties is or may be inadequate, it is not necessary to show that such parties or their counsel are not acting in good faith, or are not properly discharging their duties, either in prosecuting or defending the action . . ."

c. In *Wolpe*, the court granted a property owner the right to intervene under Rule 24(a)(2) in a suit where a zoning commission had failed to appeal. The court held: ". . . there is enough in the record to show that in refusing to take an appeal the Commission did not adequately represent the intervenors' interest." (144 F. 2d at 508) It did not require a showing that the board had acted in bad faith, collusively or negligently. In fact, at an earlier point it noted there is a ". . . strong presumption that they [the zoning board] properly performed their duties".

The rule enunciated in *Pellegrino, Atlantic Refining* and *Wolpe* supports intervention here, where the applicants seek to assert a claim already deemed worthy of prosecution, not

only by four members of the Second Circuit, but by the members of the Board of Directors themselves when they authorized the petition for rehearing *en banc*.

Park & Tilford involved, as here, an attempt by a minority shareholder to intervene in an action by a corporation against individuals who had misused their control of the corporation. The defendants were trustees of a trust created by their father who was a former president of the plaintiff corporation and was its board chairman when the suit was commenced. One of the defendants was also on the plaintiff's board. The court reversed denial of intervention. It held, without requiring showing of bad faith (160 F. 2d at 988):

> "With reference to Kogan's application to intervene below, we think, as we have indicated in allowing her to intervene here, that the interests of minority shareholders were not adequately represented by existing parties to the action. Under the circumstances here disclosed, the interests represented by defendants and their father were so dominant in the *affairs of plaintiff that the District Court should have allowed stockholder representation to guard against even the appearance of any concerted action.*" (Emphasis added.)

See *Kozak* v. *Wells*, 278 F. 2d 104, 110 (8th Cir. 1960) where

> ". . . a positive showing that such representation is inadequate is not necessary."

Defendants have attempted to distinguish both *Pellegrino* and *Park & Tilford* on the ground that they involved suits brought under § 16(b) Securities Exchange Act of

1934. That section permits suit on behalf of the corporation for insiders' "short-swing" profits if the corporation fails to do so within 60 days after request or fails diligently to prosecute the suit thereafter. Alleghany and the defendants have contended that because of § 16(b), the teaching of those cases is not relevant. This is meritless.

In *Pellegrino* the Court held that refusal of the board to appeal an action against key corporate employees satisfied the inadequate representation requirement of Rule 24(a)(2) without reference to the mandate of § 16(b) (203 F. 2d at 468). It said:

> "It is clear, from what has already been said, that intervention should have been granted under Rule 24(a)(2) of the Federal Rules of Civil Procedure, because representation of appellant's interest is 'inadequate,' appellee corporation having decided not to appeal from the judgments of the trial court, and appellant will be 'bound by a judgment in the action.'" (203 F. 2d at 468; footnote omitted)

The Court then went on to state as an alternative ground that since the statutory requirements of § 16(b) had been met, intervention should also have been allowed under Rule 24(a)(1) which provides for intervention when a statute confers an unconditional right.

Likewise, the Second Circuit, in deciding the intervention requirements in *Park & Tilford,* looked to the criteria of Rule 24(a)(2) rather than the language of § 16(b); and it decided the issue of adequate representation without reference to § 16(b) (160 F. 2d at 988). Accord: *Molybdenum Corporation of America* v. *International Mining Corp.,* 32 F. R. D. 415 (S. D. N. Y. 1963).*

*In *Molybdenum,* the District Court held that intervenors under § 16(b) must meet Rule 24(a)(2) requirements and that "the close relationship between the [corporation] and the defendants . . ." and

2. The Defendants' Authorities.

In holding that a showing of "bad faith, collusion or negligence" was necessary to intervene, the majority below discussed none of the foregoing cases. Its only citation on this issue was *Sam Fox Publishing Co.* v. *United States,* 366 U. S. 683 (1961). Although the Circuit Court's citation was preceded by the signal "Cf.", it is difficult to fix precisely its reliance on *Sam Fox*. Defendants and Alleghany, however, make clear they rely on the dictum found in a footnote on p. 692 of this Court's opinion (Brief of Respondent Alleghany in Opposition to Petition p. 9, Brief of Respondents Kirby et al in Opposition to Petition p. 9).* That dictum and the rest of the *Sam Fox* opinion gives no solace to defendants and no support for the majority holding. Indeed, upon analysis, *Sam Fox* supports intervention here.

The context of that dictum is: Sam Fox Publishing Co., and two others, attempted to intervene as of right in a proceeding to modify an earlier consent decree in a Government antitrust suit against ASCAP.** Intervenors were small publisher members of ASCAP. The Government proceeding to modify won a court approved amendment of the

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defendants' ownership of approximately 12% of the voting stock of the corporation was sufficient to meet the requirements of Rule 24(a)(2) (id. at 417). It stated that intervention should be allowed "to guard against even the appearance of any concerted action" (id. at 420):

> "The possibility that '[d]omination may spring as readily from subtle or unexercised power as from arbitrary imposition of command' is not unreal. *North American Co.* v. *S. E. C.*, 327 U. S. 686, 693, 66 S. Ct. 785, 790, 90 L. Ed. 945 (1946)."

*"The issue of inadequacy of representation could arise on this phase of the case only on some showing that ASCAP, which ostensibly has the same interests as appellants on this aspect of the litigation, was in fact conducting the litigation in bad faith, collusively, or negligently. No such contention has been made." (366 U. S. at p. 692, n. 4)

**American Society of Composers, Authors and Publishers.

decree which substantially increased the protection afforded the smaller publisher members. But intervenors claimed the modification did not go far enough and moved to intervene, prior to adoption of the modified decree. The District Court denied intervention. Appeal to this Court ensued.

In dealing with the contention that the ASCAP Board did not adequately represent intervenors' interests, this Court explained that the ASCAP Board represented the intervenors in two distinctly dissimilar areas: (1) violations relating to the external activities of the Society, as well as (2) violations relating to the interests of the members *inter sese.*

As to the phase of the board's representation, which dealt with the members *inter sese, i.e.,* the portion of the case which involved claims by the intervenors against the board itself, this Court held "that ASCAP, acting through its Board cannot in law be deemed adequately to represent appellants' discreet interests asserted against the Board." (id. at 691). Intervention was denied nonetheless because as to this aspect of the case, intervenors would not be bound by the judgment.

As to the board's representation in the former phase (*i.e.,* the board's conduct of external affairs), this Court observed that the intervenors and ASCAP "ostensibly [had] the same interests" (id. at 692, n. 4) and that the intervenors "are or may be bound by the consent judgment. . . .", but held that there was no ". . . claim on this score that ASCAP's representation was not fully adequate." (id. at 692). It was to this last phrase that this Court footnoted its observation, quoted above, that inadequacy of representation under such circumstances would require a showing of bad faith, collusion or negligence.

Petitioners here seek to intervene in relation to a matter as to which their interests clearly are not the same as the

interests of those who control the Corporation. Hence, the facts here in no way resemble the aspect of *Sam Fox* with which this Court was dealing in the footnote relied upon by defendants and Alleghany. On the contrary, they are seeking to assert a $60,000,000 claim against the shareholder who controls the Corporation and has chosen the Board. The situation here, therefore, is similar to the *"inter sese"* phase of *Sam Fox*. As to representation in matters touching such disputes, this Court held that the representation by the board cannot in law be deemed adequate. Insofar as it is relevant, *Sam Fox* supports reversal of the opinion.

3. Failure to Prosecute a Meritorious Claim Could, if Necessary, Permit Intervention.

In reaching its conclusion that a showing of bad faith was necessary, the majority not only misapplied *Sam Fox*, it also misconceived petitioners' contentions. As pointed out above, the majority apparently believed that petitioners' application was predicated solely on the failure to prosecute. It held that such failure, even when coupled with a 4-4 split of the Circuit Court, did not amount to inadequate representation. We repeat, this approach ignores Kirby's control of the Corporation. Therefore, it is not necessary to take issue with that holding in order to reverse. We believe, however, that if necessary, this Court could hold that failure to appeal where the case manifests some merit or where substantial questions are involved alone constitutes inadequate representation.

The only two cases found which involve applications to intervene at a time when the litigation had been completely abandoned and the intervenors were not being represented

in the action at all are: *Wolpe* v. *Poretsky,* 144 F. 2d 505 (D. C. Cir. 1944), and *Pellegrino* v. *Nesbit,* 203 F. 2d 463 (9th Cir. 1953). Both cases support the rule rejected by the Court below. In *Wolpe,* it was said:

> "We do not go so far as to hold that adequate representation requires an appeal in every case. * * * We do not pass on the merits of the court's findings or decree because the evidence is not before us. We only indicate that *there is enough in the record* to show that in refusing to take an appeal the Commission did not adequately represent the intervenors' interests."* (Emphasis added.) (144 F. 2d at 507-08)

The *Pellegrino* opinion stated:

> "Although diligent prosecution may not require an appeal in every case where a trial court enters judgment for the defendant, stockholder intervention for the purpose of perfecting an appeal from such a judgment should be liberally granted where the judgment of the trial court raises substantial and important questions of law in relation to its correctness."

The teaching of *Wolpe* and *Pellegrino* is that, even if Kirby did not control Alleghany, the Circuit Court was in error in holding that petitioners have been adequately represented.

Sam Fox also suggests that the Court below was in error on this point. In support of its conclusion, the majority below reasoned that if there had been a 5-3 vote against going ahead (R. 2386):

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*The Court's view of the record was that it afforded appellants a chance to succeed (id. at 507-08).

> ". . . with the three dissenting directors being fully independent (three hypothetical bishops or even the applicants themselves and a member of the law firm they have engaged). We have no doubt that after such a decision, and absent any claim of fraud or wrongdoing, the shareholders could not intervene as of right on the basis of inadequate representation, notwithstanding the fact that this Court affirmed the lower Court judgment by a 4-to-4 vote". (Footnote omitted)

But in *Sam Fox,* the ASCAP Board, as a result of earlier court orders, did have members whose specific job was to represent the small publishers and who apparently were "fully independent" (366 U. S. at 686). Such representation on the Board did not prevent this Court from holding that where those who controlled ASCAP had interests different than the intervenors, the representation by the Board was inadequate. See *Molybdenum Corporation of America* v. *International Mining Corp.,* 32 F. R. D. 415 (S. D. N. Y. 1963), where the fact that the litigation in question was being supervised by "a committee of three directors . . . all of whom are not employees of the plaintiff and are not affiliated with either defendant" (id. at 418) did not prevent a finding of inadequate representation where the defendant had a substantial share of the stock and substantial connection with directors, other than the three who were supervising the litigation.

Alleghany places great stress on *Swanson* v. *Traer,* 249 F. 2d 854 (7th Cir. 1957), to support their contention that a positive showing of bad faith is necessary here.* *Swanson* dealt with the standards applicable when shareholders seek to institute an action after directors have voted not to sue.

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*Brief of Respondent Alleghany Corporation in opposition to Petition for Writ of Certiorari, pp. 7-8.

Those standards are, of course, different from the criteria of Rule 24(a)(2) when shareholders are seeking to intervene in an existing action.* Therefore, *Swanson* is not relevant here. But, even if Alleghany is correct in its contention that the standards set forth in *Swanson* should be substituted for the Rule 24(a)(2) criteria, intervention should be allowed here.

Swanson, in a portion of the opinion not cited by Alleghany, states:

> "If the directors who constitute a majority of the board and who reject the demand are dishonest, guilty of a breach of trust, were participants in the fraudulent acts relied upon by the stockholder as a basis for the legal action which he demands, *or are subject to the control of the alleged wrongdoers,* then equitable jurisdiction may be invoked and he may proceed to file the suit himself." (Emphasis added.)

Here the Board of Directors is clearly "subject to the control of the alleged wrongdoers". Hence, under the rule set forth in *Swanson,* this suit could have been instituted by petitioners. *A fortiorari,* they should be allowed to intervene.**

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*The courts seek to discourage the filing of non-meritorious claims. A corporation's decision not to sue is some evidence that the claim lacks merit. In those situations the courts demand some countervailing evidence—in the form of facts which impugn the corporation's motives—before they permit a shareholder to assert the claim rejected by the corporation. Where, however, a suit has been instituted, the question of whether the claim is meritorious, has been resolved and parties desiring to intervene need not show corruption or fraud on the part of those directors. In principle, the more firmly the merits of the action have been established, the more readily intervention should be allowed.

**Alleghany has stated in regard to *Swanson*: "It is noteworthy that petitioners failed to comment on this leading case either in the Court of Appeals or in their petition here." (Brief of Respondent

If the rule of the majority is allowed to stand, then minority shareholders will be powerless in a case brought by the corporation to prevent destruction of the corporate claim by the empty ceremonials of the board whose members are beholden to the one who controls the corporation. The salutary principle of Rule 24(a)(2) will be dead in such a case.

As the result of the split decision of the Second Circuit, it may well be that every derivative action, where the defendant acquires control of the corporation, will end when the defendant wants it to end, because the minority shareholder is unable to prove that "the mental state of the corporate management and its counsel" evidences bad faith or is unable to demonstrate the real effect of the "subtle or unexercised power" of the defendant. Such a rule misconceives the purpose of Rule 24(a)(2) and substantially diminishes the ability of shareholders to rectify abuses of corporate trust by those who control the corporation.

II. THE MOTION TO INTERVENE WAS TIMELY UNDER THE MEANING OF RULE 24(a)(2).

Judge Hays, in his dissent, stated (R. 2387):

> "The application for intervention was obviously 'timely' within the meaning of Rule 24. The requirement of timeliness in that Rule refers not to some vague standard of laches but to the making of an application at a time when granting it will not prejudice or delay the conduct of the action by the original parties. There is no such prejudice or delay here. Nor,

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Alleghany Corporation in Opposition to Petition for a Writ of Certiorari, p. 7) They are in error. Petitioners did cite and explain *Swanson* in its brief to the Court of Appeals (p. 14). Alleghany, in its effort to pump some importance into *Swanson*, has carelessly confused petitioners' briefs with those of defendants Kirby, et al. It was the latter who did not find this "leading case" relevant enough to cite.

> for that matter, was there any laches. The application was made promptly upon the discovery that the applicants' interests were no longer being adequately represented."

The dissent was correct in holding that "prejudice or delay in the conduct of the action by the original parties" is the true test. "We feel that the requirement of timeliness is satisfied here . . . prejudice on the time factor alone is neither apparent nor asserted." *Kozak* v. *Wells,* 278 F. 2d 104 (8th Cir. 1960). Compare, *Cameron* v. *President and Fellows of Harvard College,* 157 F. 2d 993, 996 (1st Cir. 1946). See, *Tennessee Coal, Iron & R. Co.* v. *Muscoda Local 123,* 5 F. R. D. 174, 177 (N. D. Ala. 1946).

The majority rejected this test, stating (R. 2385):

> ". . . the timeliness requirement . . . is related to the question whether the shareholders' interests are or may be inadequately represented, for whether an application to intervene is prompt or tardy also turns on when the itnerests of the proposed intervenors were no longer properly represented."

It then held that in order to be timely, the intervention attempt should have been made when Kirby regained control of Alleghany.

Even if we accept the majority's test, its conclusion is erroneous. It overlooks the fact that until the Board voted to abandon this litigation, the action was being diligently prosecuted by the Corporation. Representation, therefore, became inadequate not when Kirby regained control, but when that fact was followed by the vote not to seek review. "In the instant case appellant had no right to intervene so long as the corporation was diligently prosecuting the action." *Pellegrino* v. *Nesbit,* 203 F. 2d 463, 466 (9th Cir.

1953). Here intervention was sought within four days after learning of the Board's unpublicized decision to cease litigating Alleghany's claim.*

As pointed out above, in treating the inadequacy issue, the majority ignores Kirby's regaining of control of the Corporation. In treating the timeliness issue, it selected that event as the measure of timeliness, without regard to other key aspects of this case, especially the vote not to go ahead. We urge both the issue as to timeliness and inadequacy must be determined by taking cognizance of all the operative facts.

CONCLUSION

Accordingly, we respectfully request that the order denying intervention be reversed and that this Court make an order allowing intervention by petitioners as parties plaintiff.

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January 21, 1966

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*Compare the situation here to the one in *Pellegrino, supra*:

> "Appellant was first informed of the decision by the corporation not to appeal the judgments by a letter dated November 15, 1951, and mailed from New York City to Los Angeles. The motion for leave to intervene was filed on November 27, 1951. Such motion was, under the circumstances, timely." (id. at 466).

APPENDIX

Rule 24, Federal Rules of Civil Procedure

INTERVENTION.

(a) *Intervention of Right.* Upon timely application anyone shall be permitted to intervene in an action: (1) when a statute of the United States confers an unconditional right to intervene; or (2) when the representation of the applicant's interest by existing parties is or may be inadequate and the applicant is or may be bound by a judgment in the action; or (3) when the applicant is so situated as to be adversely affected by a distribution or other disposition of property which is in the custody or subject to the control or disposition of the court or of an officer thereof. [As amended Dec. 27, 1946, effective March 19, 1948.]

* * *

(c) *Procedure.* A person desiring to intervene shall serve a motion to intervene upon the parties as provided in Rule 5. The motion shall state the grounds therefor and shall be accompanied by a pleading setting forth the claim or defense for which intervention is sought. The same procedure shall be followed when a statute of the United States gives a right to intervene. When the constitutionality of an act of Congress affecting the public interest is drawn in question in any action to which the United States or an officer, agency, or employee thereof is not a party, the court shall notify the Attorney General of the United States as provided in Title 28, U. S. C. § 2403. [As amended Jan. 21, 1963, effective July 1, 1963.]